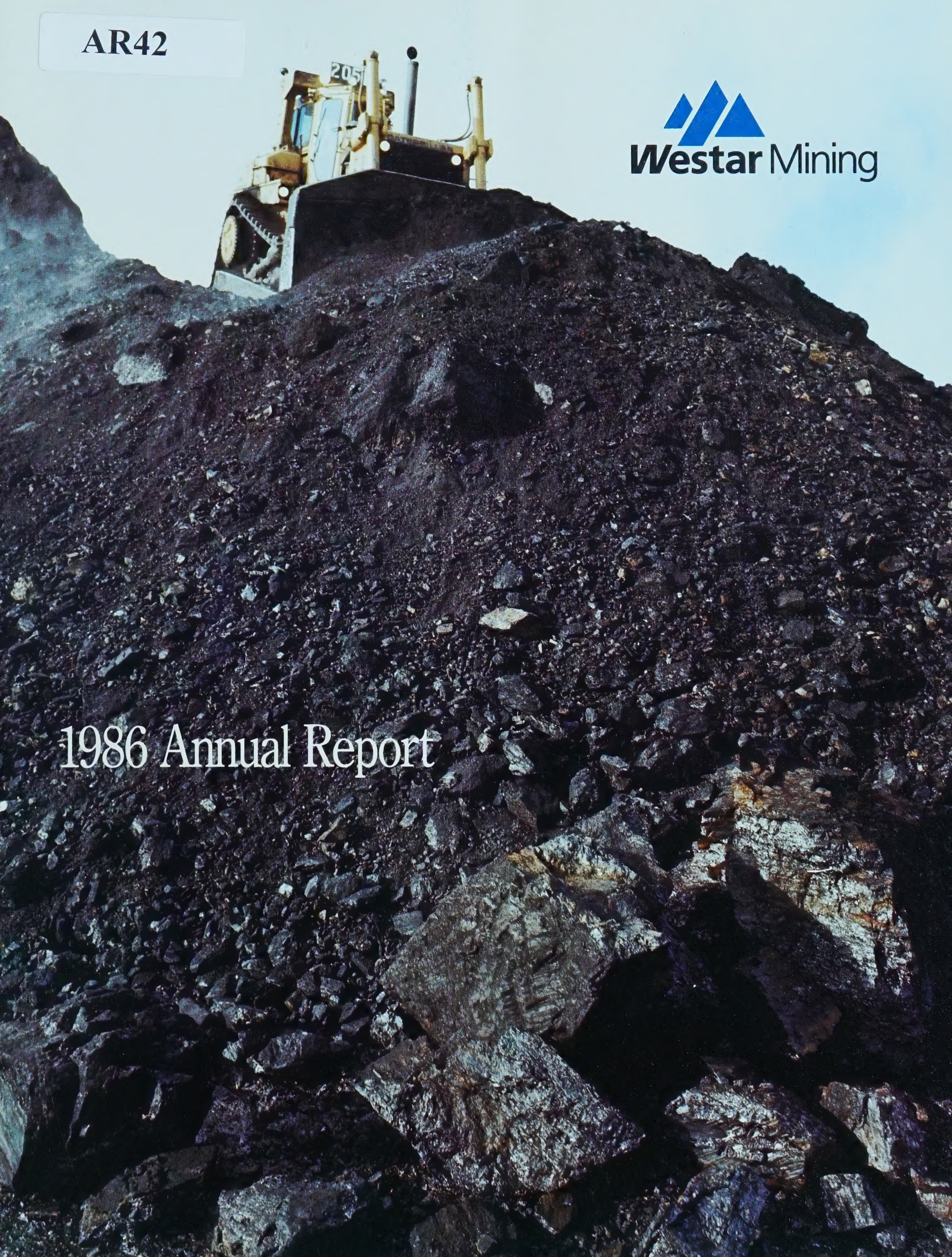


Westar Mining

1986 Annual Report

Corporate Profile

Westar Mining

Westar Mining Ltd. produces and markets coal from two surface mines in southeastern British Columbia.

The Company is Canada's largest exporter of metallurgical coal used in the manufacture of steel, and a supplier of thermal coal to power plants and specialized industries.

At its Balmer mine in Sparwood, B.C. the Company operates a truck and shovel surface mine and related coal processing facilities. Its Greenhills mine is located near Elkford, B.C. and consists of a surface mine and processing facilities.

Marketing and customer relations activities are based at the Company's registered office in Vancouver, B.C. with sales offices in Tokyo and Paris.

Westar Mining is owned 67 percent by British Columbia Resources Investment Corporation and 33 percent by Mitsubishi Corporation and nine Japanese corporations which are also consumers of the Company's coal. The Greenhills Mine is owned 80 percent by Westar Mining and 20 percent by Pohang Iron and Steel Company of Korea.

The Company has about 1,700 employees and 2,000 holders of Preferred shares.

Highlights

	1986	1985 Restated (4)
	(Millions)	
Operations		
Coal shipments (tonnes) — Metallurgical (1)	**5.4**	6.9
— Thermal (1)	**1.0**	1.2
Oil and NGL production (barrels) (2)	**1.8**	2.7
Sales ($)	**370.7**	515.1
Earnings ($)		
Continuing operations	**(6.2)**	21.1
Discontinued operations (3)	**(15.5)**	13.6
Extraordinary items	**(79.1)**	(221.5)
Net earnings (loss)	**(100.8)**	(186.8)
Cash Flow Information ($)		
Funds provided by continuing operations	**12.8**	59.2
Capital expenditures	**15.5**	13.4
Financial Position ($)		
Working capital	**24.8**	12.2
Total assets of continuing operations	**578.8**	577.1
Net assets of discontinued operations (3)	**—**	251.6
Total assets	**578.8**	828.7
Total long-term debt obligations	**477.7**	627.8
Shareholders' equity	**(131.1)**	(21.6)
Other Information		
Number of employees (at December 31)	**1714**	1906
Wages, salaries and employee benefits ($)	**83.6**	109.2

NOTES

(1) Includes 100% of the Greenhills Mine Joint Venture shipments.

(2) 1986 includes seven months' production data only.

(3) These amounts relate to the operations and net assets of the Company's United Kingdom oil and gas division that were disposed of on August 22, 1986.

(4) Comparative financial information has been restated to reflect a prior period adjustment.

Westar Mining had to respond in 1986 to major pressures on both the production and marketing of coal.

Production at both the Balmer and Greenhills mines was curtailed due to labor disruptions. As well, coal prices and volumes moved downward. As a consequence, the Company omitted the January 15, 1987 Preferred share dividend.

The Company responded to these difficulties with productivity improvements. Both the Balmer and Greenhills mines revised their mine plans and operating procedures to extract coal more efficiently and to meet changing market demands. The Company also completed major organizational changes.

An over supplied coal market will continue to pressure Westar Mining to remain one of Canada's most competitive coal mining operations in terms of quality, cost and marketing.

In August 1986 the North Sea Brae Field oil and gas interests were sold.

Financial results

The Company recorded a loss before extraordinary items in 1986 of $21.7 million compared to earnings of $34.7 million the previous year.

After extraordinary items the Company recorded a loss of $100.8 million for the year compared to a loss of $186.8 million in 1985. The extraordinary items in 1986 largely relate to a loss on the sale of the North Sea oil and gas assets. The operating results of the oil and gas division have been recorded separately as discontinued operations for both years.

Total sales amounted to $370.7 million in 1986 down from $515.1 million in 1985 as a result of lower coal prices and volumes. In addition oil price declines and the sale of North Sea interests in August contributed to lower revenues.

The loss from mining operations was $6.2 million compared to earnings of $21.1 million in 1985. Funds provided by operations decreased to $12.8 million in 1986 from $59.2 million the previous year.

The U.K. oil and gas operations also recorded a loss for the first seven months of 1986 of $15.5 million compared to earnings of $13.6 million for the year 1985.

Debt refinancing

The Company continued discussions with its lenders throughout the year to obtain amendments to its loan agreements.

The further decline in coal price and volumes announced by the Japanese steel mills in January 1987 has delayed a long term refinancing agreement with the lenders until such time as coal market trends can be assessed.

The Company's bank debt was reduced by $188 million during 1986 of which $156.1 million was attributable to proceeds from the sale of the Company's North Sea oil and gas interests.

Prior to the sale of the North Sea Brae Field, Westar Mining's consolidated debt was serviced from both coal sales and revenues from the North Sea oil and gas operations. The Brae sale reduced the consolidated debt but also eliminated the cash flow from oil production in the North Sea. As a result Westar Mining has to service its debt from cash flow generated only by its coal operations.

Coal operations

Westar Mining's total coal shipments from both mines decreased in 1986 to 6.4 million tonnes from 8.1 million tonnes in 1985 mainly as a result of the 16 weeks' labor disruption at the Balmer mine and a seven and a half week lockout/strike at the Greenhills mine.

Coal shipments from Balmer were made up of 3.6 million tonnes of metallurgical coal and 0.3 million tonnes of thermal coal. This compares to 1985 shipments of 5.2 million tonnes of metallurgical coal and 0.6 million tonnes of thermal coal.

The 80 per cent owned Greenhills mine shipped 1.8 million tonnes of metallurgical coal and 0.7 million tonnes of thermal coal in 1986 compared to 1.7 million tonnes of metallurgical coal and 0.6 million tonnes of thermal coal in 1985.

Balmer
A four month work stoppage at the Balmer mine in Sparwood overshadowed the year's activities. The dispute began in May with a series of rotating strikes by members of the United Mine Workers of America. During these disruptions costs rose and productivity fell dramatically until the Company imposed a lockout on June 10. The mine eventually reopened on October 2 when the Company and the bargaining unit agreed on a three year contract.

During the year, Balmer revised its mine plans to reduce haul distances, grades and strip ratios, to increase operational efficiences and achieve further cost reductions, as well as to meet market demands for new blends of coal.

The Balmer mine continues to be one of Canada's leading coal mines in terms of productivity, efficiency and quality.

Greenhills
The Greenhills mine was closed for 22 days during the Spring to reduce inventories. A lockout/strike shut down the mine for a further 53 days following more than a year of negotiations with the Greenhills Workers Association. Work resumed in May after the Company and the Association signed a three year agreement.

Full capacity rock production was not achieved for three months following the shutdown, but by the end of the year target production levels had been exceeded and a record was set in December.

The mine plan has been redesigned with steepened walls to reduce the strip ratio and to give operators better access to the entire cross section of coal seams.

Greenhills is now operating at or above capacity levels and the coal quality is meeting the original expectations.

Organizational Changes
Late in 1986 the Company decentralized the Balmer and Greenhills mines. John Powell was appointed as Vice President, Coal Mining Operations and General Manager of the Balmer mine and Sam Oishi as General Manager of the Greenhills mine.

The Company wishes to record its gratitude to Lawrence Riffel and Junie Lindsay the former General Managers of the Balmer and Greenhills mines for their significant contributions to these mines during their careers with the Company.

Oil and gas
During 1986 Westar Mining sold its U.K. oil and gas interests to reduce its exposure to fluctuating world oil prices and eliminate future capital expenditure commitments on further development of the Brae Field in the North Sea. The first stage in this process occurred in January of 1986 when Westar Mining cancelled its 7.7% funding obligation to Bow Valley Industries Ltd. of Calgary. This transaction permitted the subsequent sale of Westar Mining's 7.7% working interest in the Brae.

This interest was purchased by Dyas, a private Dutch-owned company in August 1986 for $173 million and resulted in an extraordinary loss of $75.5 million.

Engineering
As a consequence of declining internal demand for engineering services and to reduce overhead costs, Westar Mining sold Westar Engineering Ltd., the Company's former consulting subsidiary, to a group of employees in December 1986.

With this sale Bob Gronotte, President of Westar Engineering and formerly Senior Vice President, Engineering and Capital Projects of Westar Mining, retired after almost 30 years of service with the Company during which time he was responsible for the building of the Greenhills mine and the expansion of the coal port.

Marketing
Westar Mining's marketing team performed well in the face

of world oversupply of coal and weak prices.

The profitability of the Japanese steel industry, Westar Mining's major customer, has eroded as the yen currency appreciated by approximately 60 per cent against the U.S. dollar since 1985. This revaluation has undermined the competitiveness of Japanese products in world markets by driving up prices of Japanese products in terms of purchasers' currencies.

The Japanese steel industry has been forced to cut back production from 105 million tonnes of steel in 1985 to 98 million tonnes of steel in 1986. This has reduced the demand for coal. In addition, the steel mills have refined their production processes to use lower quality and lower priced coals.

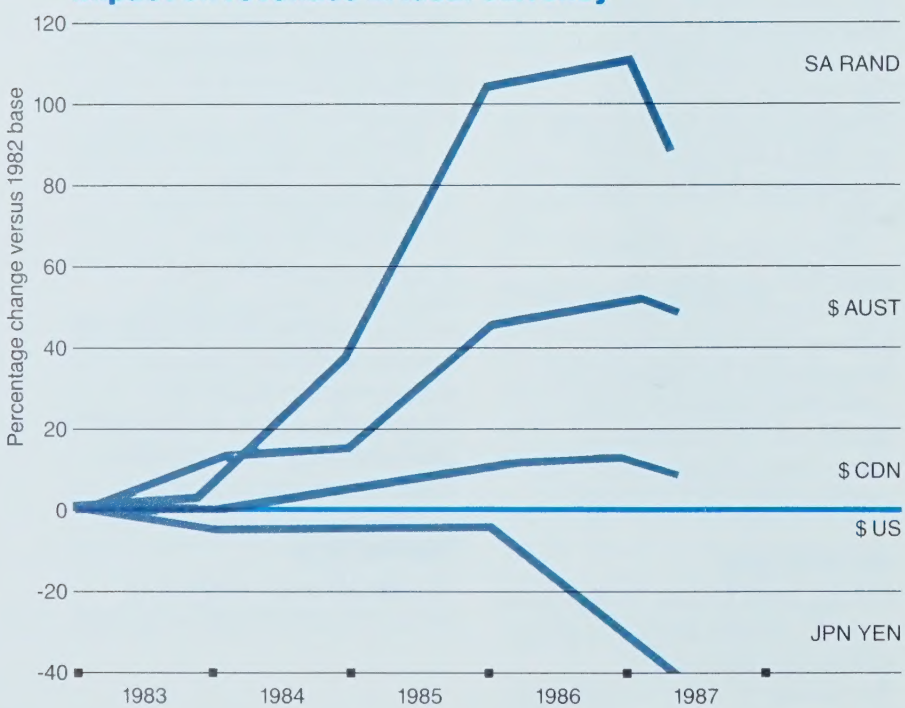
While Japan suffered from a stronger yen, Australia and South Africa, Canada's major competitors in the world coal trade, reaped the benefits of weaker currencies. Their weaker currencies allow them to sell their coal for lower U.S. dollar prices without reducing their profit margins in their own currencies. Almost all international coal sales are denominated in U.S. dollars. Also, South Africa, in response to European sanctions, has been forced to look for replacement markets in other parts of the world. While this political development has helped boost Westar sales to Europe, it increases competition in Pacific Rim markets.

The Company's strategy is to continue to diversify its markets and reduce its dependence on Japan. Five years ago 70 per cent of all the Company's metallurgical coal went to Japanese steelmakers. That percentage has decreased to 45 per cent today.

A major focus of marketing activities has been on European markets. European coal sales have increased to 20 per cent of total sales since the Company secured its first European customer in 1976. The Company's commitment to that market was confirmed in 1984 when a permanent office was established in Paris. In 1986 Westar Mining solidified its presence by successfully renegotiating major contracts with customers in France and England.

The Company is also developing new customers for both metallurgical and thermal coals in the United States and is actively diversifying markets in Asia, Europe and Central and South America. Westar Mining currently sells coal to customers in 19 countries.

Exchange rate movements versus US dollar impact on revenues in local currency



This graph demonstrates the effects of exchange rate changes since 1982.

For commodities sold in U.S. dollars, revenue in terms of domestic currency has increased for Canada, but much more significantly, for Australia and South Africa.

For Japan, on the other hand, revenue in yen, on U.S. dollar sales, has decreased dramatically.

Dividend omissions

In December 1986 the Board of Directors decided not to declare the January 15, 1987

quarterly dividend on the Company's $2.5625 Cumulative Redeemable Class A Preferred Shares, Series 1.

The Directors cited the negative impact on cash flow of the four month shutdown at the Balmer mine and continuing soft coal markets as reasons for the decision. The Board felt that it was in the best interests of the Company to conserve cash at this time.

The Directors will review their decision on a regular basis. At their February meeting the Directors agreed to continue the suspension of dividends.

Westar Industries Ltd. a subsidiary of British Columbia Resources Investment Corporation, did not declare the December 1986 quarterly dividend amounting to $2 million on its 115,000 Class C Preferred shares owned by Westar Mining.

Employees

1986 was a particularly tough year for all employees. As well as decentralizing the organization at the two mines, corporate functions formerly performed at the head office in Vancouver, with the exception of the Marketing and Traffic departments, were moved to the offices at Sparwood. These programs involved the transfer or lay-off of 22 people at Vancouver with an additional 58 people laid off at the office in Sparwood.

The total number of employees at Westar Mining decreased by 177 in 1986 to 1714 at year end, excluding the London office employees, who ceased to be employees of Westar Mining following the sale of the U.K. assets.

In November 1986 L. Jack Smith was appointed President of Westar Mining following the resignation of Gary K. Livingstone.

The Board wishes to record its appreciation to Mr. Livingstone for his significant contributions to the Company during the past 16 years and to also thank both current and former employees for their efforts in maintaining the Company's competitive position in these difficult times.

Mr. Smith became Chairman of the Company in December 1986 following Bruce I. Howe's resignation.

Outlook

In January 1987 the Japanese steel mills, which set the pattern for world coal prices, announced further reductions in the price of metallurgical coal for the contract year beginning April 1, 1987. The price has been reduced from U.S.$49 for the Balmer mine and U.S.$49.50 for the Greenhills mine to U.S.$44 per tonne for metallurgical coals from both of these mines. In addition the Japanese have indicated they will take 37.5 per cent of their original contract volume of 4.37 million tonnes with the Balmer mine and 40 per cent of their original contract volume of 0.76 million tonnes with the Greenhills mine. These volumes compare to an indicated take in 1986 of 50 per cent of the original contract volumes for each mine.

Canadian coal suppliers will continue to face tough competition from producers in other countries, particularly South Africa and Australia whose lower costs, proximity to markets and devalued currencies provide substantial advantages.

The major objective of Westar Mining in 1987 is to maintain its position in world coal markets. The three year labor contracts at both Balmer and Greenhills will help minimize labor disruptions and improve reliability of supply. The mine plans at both operations are concentrated on increasing productivity and controlling costs.

The keys to Westar Mining's future prosperity are product enhancement, productivity improvements, stringent cost control and diversification of its customer base.

On behalf of the Board of Directors,

L. Jack Smith
Chairman and President

March 23, 1987

Highlights

1986 was a frustrating year for Westar Mining. While soft coal markets continued to exert downward pressure on prices and volumes, labor disputes curtailed production for extended periods at both mines. The selling price of all of the Company's products is now denominated in U.S. dollars and consequently any change in the relative exchange rate between the Canadian dollar and the U.S. dollar has a major impact on the Company's fortunes.

The Company sold its oil and gas interests in the United Kingdom in August, 1986 for $173 million resulting in an extraordinary loss of $75.5 million dollars. The results of the oil and gas division which include operating activities up to July 31, 1986 have been segregated and recorded as discontinued operations. The net assets of the oil and gas division have also been segregated on the December 31, 1985 balance sheet as net assets of discontinued operations to facilitate comparability of financial statements.

Coal

Revenues from Balmer operations were down 35% in 1986 due to the prolonged labor dispute at that mine. Revenues from the Greenhills mine, however, were the same as 1985 despite the fact that the mine was closed for 2½ months during the year due to inventory shutdowns and a labor dispute. Prices for all products were lower in 1986 but the Company mitigated the problem to a certain extent by hedging future sales contracts in light of the weakening U.S. dollar.

The contract price for the sale of Balmer metallurgical coal to the Japanese steel mills, which is also the basis for pricing to other Pacific Rim customers, became U.S.$49 effective April 1, 1986. The contract price for Greenhills metallurgical coal to its Pacific Rim customers became U.S.$49.50 effective April 1, 1986. These prices represent decreases of approximately $0.40 and $12.00 respectively from the previous year's contract prices at exchange rates prevailing in early 1986. For the 1987 coal year, metallurgical coal sold to the Japanese steel mills under contract has been further reduced to U.S.$44 per tonne for both Balmer and Greenhills.

The effect of these price decreases has been further compounded by the replacement of some of the Company's traditional coking coal products with lower priced semi-soft coking coals. While the Company's major customers continue to have unutilized capacity in their coke ovens it is possible for them to use more of this lower priced product.

Thermal coal prices also decreased in 1986 due primarily to the market oversupply situation and the slight weakening of the U.S. dollar against the Canadian dollar.

Operating costs increased by 7% in 1986 despite stringent cost control measures and staff reductions due primarily to the effect of the labor disputes at both mines. During a labor dispute or any formal shutdown the Company continues to absorb fixed costs while there is no production taking place. This means that the coal that is actually produced has to absorb a higher percentage of fixed costs, thus increasing the unit cost per tonne of coal produced.

General and administrative expenses increased in 1986 due primarily to severance costs associated with the restructuring of the Company's head office. The benefits associated with this re-organization will be reflected in 1987.

Depreciation, depletion and amortization expense decreased to $18.5 million in 1986 from $30.9 million in 1985 due to the prolonged shutdown periods during 1986. The Company depreciates its assets on a unit of production basis and thus does not charge depreciation when the asset is not in use.

Oil and Gas

The Company sold its oil and gas division in the United Kingdom in August, 1986 and thus the loss from discontinued operations represents operating activities for the first 7 months of 1986 only. The poor performance of the oil and gas division in 1986 is a direct result of the dramatic reduction

in oil prices during 1986. The price of a barrel of crude oil at July 31, 1986 was U.S.$10.00 compared to U.S.$28.00 at December 31, 1985.

Financing Costs

Interest costs on long term borrowings charged to continuing operations decreased by $7.1 million to $28.6 million in 1986 due primarily to the reduction in long-term debt in 1986 as a result of the sale of the oil and gas assets in the United Kingdom. This transaction had the effect of immediately reducing the long-term debt outstanding by $156 million.

Funds Provided by Operating Activities

Funds provided by continuing operations decreased significantly in 1986 due primarily to the lower earnings levels. Funds provided by discontinued operations also decreased in 1986 for the same reason. Funds provided by working capital changes increased by $30 million in 1986 due primarily to a reduction of inventories. Inventory levels had increased by $20 million in 1985.

Capital Expenditures

Capital expenditures for coal operations increased to $15.5 million in 1986 from $13.4 million in 1985. The major expenditure item in 1986 was pollution control equipment for the coal preparation plant at the Balmer mine. The remaining expenditures were for equipment additions and replacements at both mines.

Long-Term Debt

Long-term bank debt decreased to $372.7 million at December 31, 1986 from $560.9 million at the end of 1985. The decrease was primarily due to the sale of the Company's oil and gas assets in the United Kingdom. The proceeds of the sale were applied directly to the reduction of long-term debt outstanding. The Company also received a loan from MC Resources Ltd., a subsidiary of Mitsubishi Corporation of Japan, of $30 million during the year. Mitsubishi Corporation, through MC Resources Ltd., owns 13.1% of the outstanding common shares of the Company. Interest on the loan is based on 69% of the prevailing prime rate of a Canadian chartered bank and the loan is repayable in full in October, 1989. At December 31, 1986 the Company's long term bank debt included U.S.$261.6 million which was converted at the year-end exchange rate of U.S.$1 equivalent to $1.3805 Canadian. This compares to an exhange rate of $1.3975 at December 31, 1985.

Refinancing Discussions

At the end of 1986, the Company was unable to comply with certain covenants under its bank credit agreements due primarily to the extraordinary write-downs that took place during 1985 and 1986. The significant price reductions for metallurgical coal which were announced in January 1987 have delayed the refinancing of the Company's long-term bank debt. For further information please refer to Note 3 to the consolidated financial statements.

Management's Responsibility for Financial Reporting

The information and consolidated financial statements in the Annual Report are the responsibility of management and the Board of Directors of the Company. The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles.

Touche Ross & Co., who were appointed by the Common shareholders as the Company's auditors, have examined the consolidated financial statements in order to express their opinion as to whether the statements present fairly the Company's financial position, results of operations and changes in financial position, in accordance with generally accepted accounting principles applied on a consistent basis. This report is presented with the consolidated financial statements.

The Audit Committee of the Board of Directors meets with management and the auditors to ensure that they are fulfilling their responsibilities and reviews with them the consolidated financial statements before approval of the statements by the Board of Directors.

Consolidated Statement of Earnings

For the year ended December 31, 1986

	Note Reference	1986	1985 (Note 5)
		(Millions)	
Sales	18	**$ 370.7**	$ 515.1
Costs and expenses			
Cost of products sold		**336.1**	403.3
General and administrative		**10.2**	9.3
Depreciation, depletion and amortization		**18.5**	30.9
		364.8	443.5
Operating profit		**5.9**	71.6
Financing costs	12	**30.3**	38.6
Other income	13	**11.4**	5.4
		18.9	33.2
Earnings (loss) before income taxes and other items		**(13.0)**	38.4
Provision for income taxes (recovery)	14	**(6.8)**	17.3
Earnings (loss) from continuing operations		**(6.2)**	21.1
Earnings (loss) from discontinued operations	5	**(15.5)**	13.6
Earnings (loss) before extraordinary items		**(21.7)**	34.7
Extraordinary items	15	**(79.1)**	(221.5)
Net earnings (loss)		**$(100.8)**	$(186.8)
Earnings (loss) per Common share			
Continuing operations		**$ (.59)**	$ .90
Discontinued operations		**(.85)**	.75
Extraordinary items		**(4.34)**	(12.14)
Net earnings (loss)		**$ (5.78)**	$(10.49)

Consolidated Balance Sheet

As at December 31, 1986

Assets	Note Reference	1986	1985 (Note 5,19)
		(Millions)	
Current			
Cash and short-term investments	11	**$ 33.8**	$ —
Accounts receivable		**19.7**	26.9
Inventories	4	**37.0**	56.4
Income taxes recoverable		**8.8**	2.1
		99.3	85.4
Net assets of discontinued operations	5	**—**	251.6
Property, plant and equipment, net	6	**363.3**	366.4
Investment in related company at cost	7	**115.0**	115.0
Other assets		**1.2**	10.3
		$ 578.8	$ 828.7

Liabilities and Shareholders' Equity	Note Reference	1986	1985
Current			
Bank indebtedness		**$ —**	$ 2.6
Accounts payable and accrued liabilities		**61.2**	50.4
Income taxes payable	19	**8.3**	8.6
Current portion of long-term debt	3,8	**5.0**	11.6
		74.5	73.2
Long-term debt	3,8	**367.7**	549.3
Due to related companies	9	**105.0**	66.9
Deferred income taxes	19	**162.7**	160.9
Shareholders' equity			
Share capital	2,10	**63.0**	63.2
Contributed surplus		**15.2**	15.2
Deficit	19	**(209.3)**	(105.0)
Translation adjustments		**—**	5.0
		(131.1)	(21.6)
Commitments and contingencies	3,11		
		$ 578.8	$ 828.7

Approved by the Directors:

L. J. Smith

Director

R. Rhone

Director

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1986

	Note Reference	1986	1985 (Note 5)
		(Millions)	
Operating Activities			
Funds provided by continuing operations	16	**$ 12.8**	$ 59.2
Funds provided by discontinued operations		**4.4**	68.9
Change in working capital		**30.1**	(20.2)
Dividends on Preferred shares		**(3.5)**	(4.6)
Funds provided		**43.8**	103.3
Investing Activities			
Additions to property, plant and equipment		**(15.5)**	(13.4)
Net assets of discontinued operations		**(5.8)**	(72.6)
Sale of subsidiary	5,15	**156.1**	88.9
Other		**1.6**	3.3
Funds provided		**136.4**	6.2
Financing Activities			
Repayments of long-term debt		**(181.9)**	(74.6)
Advances from related companies		**38.1**	66.9
Funds provided (applied)		**(143.8)**	(7.7)
Dividends on Common shares		**—**	(95.0)
Increase in cash		**36.4**	6.8
Cash at beginning of year		**(2.6)**	(9.4)
Cash at end of year		**$ 33.8**	$ (2.6)

Consolidated Statement of Deficit

For the year ended
December 31, 1986

	Note Reference	1986	1985
		(Millions)	
Retained earnings (deficit) at beginning of year as restated	19	**$(105.0)**	$ 181.4
Net earnings (loss)		**(100.8)**	(186.8)
Dividends — Preferred shares	2	**(3.5)**	(4.6)
— Common shares		**—**	(95.0)
Deficit at end of year		**$(209.3)**	$(105.0)

Auditors' Report

To the Shareholders of
Westar Mining Ltd.

We have examined the consolidated balance sheet of Westar Mining Ltd. as at December 31, 1986 and the consolidated statements of earnings, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.

Touche Ross & Co.
Chartered Accountants

Vancouver, British Columbia
January 28, 1987

Notes to the Consolidated Financial Statements
December 31, 1986

1. Summary of Significant Accounting Policies

Accounting Principles:

The Company is incorporated under the Company Act of the Province of British Columbia and prepares its accounts in accordance with generally accepted accounting principles followed in Canada.

Principles of Consolidation:

The consolidated financial statements include the accounts of all subsidiaries. The Company has an 80% interest in the Greenhills Mine Joint Venture which is proportionately consolidated.

Translation of Foreign Currencies:

The consolidated financial statements include assets and liabilities which are denominated in foreign currencies. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using the exchange rate in effect at the end of the year. The resultant gain or loss is included in net income, except for gains or losses relating to long-term liabilities, which are deferred and amortized over the life of the related item.

Inventories:

Coal inventories are valued at the lower of average cost and net realizable value. Depreciation, depletion and amortization are not included in coal inventory costs. Operating supplies are valued at average cost less a provision for obsolescence.

Property, Plant, Equipment and Related Development Costs:

Property, plant and equipment are stated at cost. During the construction or development stages of major capital projects, interest is capitalized as a cost of these projects on the basis of expenditures incurred without restriction to specific borrowings for these projects. Replacements and major improvements are capitalized. Costs of assets sold, retired or abandoned and the related amounts of accumulated depreciation are eliminated from the accounts. Gains or losses on such dispositions are included in earnings. Expenditures for repairs and maintenance of plant and equipment are charged against earnings. Plant and equipment is depreciated on a unit of production method over the estimated useful lives of the assets.

Acquisition costs of coal reserves are capitalized and depleted by the unit of production method. Coal exploration costs are charged against earnings when incurred. Costs incurred in connection with feasibility studies for new mining projects are capitalized and charged against earnings over the life of the mine or written off when it is determined that the project is not feasible. Preproduction and development costs are capitalized and amortized on the straight line basis over the life of each mine.

Pension Plans:

Annual contributions to employee pension plans are charged against earnings. Pension contributions are actuarially determined to include amounts necessary to provide for current service and for funding of past service liabilities over 15 years.

Income Taxes:

Income taxes are accounted for by the tax allocation method, whereby the provision for taxes is made in the year transactions affect net earnings rather than when such items are recognized for tax purposes. Differences between the provision for taxes and taxes currently payable are reflected as deferred income taxes. Tax benefits from earned depletion are reflected as a reduction in the provision for income taxes. Investment tax credits claimed subsequent to 1984 are deducted from the related capital expenditures.

2. Omission of Dividend

On December 8, 1986, the Board of Directors of the Company decided not to declare the January 15, 1987 quarterly dividend on the Company's $2.5625 Cumulative Redeemable Class A Preferred shares, Series 1 which would have amounted to $1.1 million.

3. Refinancing Discussions

The Company is unable to comply with certain covenants under its bank credit agreements and is continuing discussions with its two bank lenders to restructure its long-term debt repayment obligations over a time period which will be determined by available cash flow. The Company believes that the discussions will result in an acceptable refinancing.

These consolidated financial statements have been prepared on the assumption that the Company will be successful in refinancing its long-term debt. The ability of the Company to carry on its operations, and the carrying value of assets and classification of long-term debt could be significantly affected if these matters are not satisfactorily resolved.

4. Inventories

	1986	1985
	(Millions)	
Coal	**$ 20.8**	$ 38.1
Operating Supplies	**16.2**	18.3
	$ 37.0	$ 56.4

5. Discontinued Operations

On August 22, 1986, the Company sold its oil and gas interests in the United Kingdom for $173 million. The $75.5 million loss on the sale has been recorded as an extraordinary item (Note 15). Accordingly, operating results for that business are reflected in the statement of earnings as discontinued operations and are summarized as follows:

	1986	1985
	(Millions)	
Sales	**$ 38.4**	$ 99.8
Cost of products sold	**15.7**	30.2
General and administrative	**1.6**	2.1
Depreciation and depletion	**22.2**	35.9
Financing costs, net	**16.6**	(2.7)
Other expenses	**.1**	1.4
Earnings (loss) before income taxes	**(17.8)**	32.9
Provision for income taxes (recovery)	**(2.3)**	19.3
Earnings (loss) from discontinued operations	**$ (15.5)**	$ 13.6

Net assets of discontinued operations as shown in the balance sheet at December 31, 1985 are summarized as follows:

	1985
	(Millions)
Property, plant, equipment and related development costs, net	$328.4
Less: accumulated depreciation and depletion	61.0
	267.4
Other assets	33.3
	300.7
Less: Deferred income taxes	34.9
Working capital deficiency	14.2
Net assets of discontinued operations	$251.6

6. Property, Plant, Equipment

	1986	1985
	(Millions)	
Property, plant, equipment and related development costs, at cost	**$572.7**	$559.9
Accumulated depreciation, depletion and amortization	**209.4**	193.5
Net	**$363.3**	$366.4

The financial statements include $274.6 million and $285.6 million in assets and $15.8 million and $8.3 million in liabilities of the Greenhills Mine Joint Venture in 1986 and 1985 respectively.

7. Investment in Related Company

In 1985, the Company sold Westshore Terminals Ltd. to Westar Industries Ltd., a subsidiary of British Columbia Resources Investment Corporation, for 115,000 cumulative redeemable Class C Preferred shares of Westar Industries redeemable at $1,000 each. British Columbia Resources Investment Corporation through a subsidiary owns 66.6% of the outstanding Common shares of the Company.

The Class C Preferred shares pay quarterly dividends based on 70% of the prevailing prime rate of a Canadian chartered bank and carry a mandatory redemption provision whereby Westar Industries will redeem one third of the shares outstanding on each of March 31, 1990, March 31, 1991 and March 31, 1992.

On December 19, 1986, the Company was advised that Westar Industries Ltd. had decided not to declare the December 31, 1986 quarterly dividend on the Class C Preferred shares which would have amounted to $2 million.

8. Long-Term Debt

	1986	1985
	(Millions)	
Bank credit agreements	**$372.7**	$560.9
Less: Amounts due within one year	**5.0**	11.6
	$367.7	$549.3

Borrowings under the bank credit agreements can be through bankers' acceptances with a stamping fee of 1¼% or directly in Canadian or U.S. funds at prime rates plus ½% or London Interbank Offered Rate (LIBOR) plus 1%. The interest rate on U.S.$60 million has been fixed at 12.5% through an interest rate swap agreement expiring in 1990. The average cost of borrowings under these agreements was 8.7% at December 31, 1986, 9.6% at December 31, 1985.

The bank credit agreements are fully utilized at December 31, 1986. As described in Note 3, the Company is currently negotiating with its lenders to refinance these agreements. Estimated reductions in these credit facilities during 1987 of $5 million are estimates of available cash and are based on recent refinancing proposals submitted to the Company's lenders.

Long-term bank debt includes U.S.$261.6 million (1985 – U.S.$366.9 million) which is translated at the year end exchange rate.

9. Due to Related Companies

	1986	1985
	(Millions)	
Westar Industries Ltd.	**$ 75.0**	$ 66.9
MC Resources Ltd.	**30.0**	—
	$105.0	$ 66.9

Interest on the Westar Industries Ltd. loan, which is calculated based on the prevailing prime rate of a Canadian chartered bank plus one percent, is added to the principal outstanding until such time as the principal amount reaches the redemption amount of the Westar Industries Class C Preferred shares outstanding (Note 7). The loan is repayable on demand to the extent that it exceeds the redemption amount of the Westar Industries Ltd. preferred shares outstanding.

The loan from MC Resources is repayable on October 31, 1989. Interest on the loan is calculated based on 69% of the prevailing prime rate of a Canadian chartered bank and is payable quarterly. MC Resources, which is a wholly-owned subsidiary of Mitsubishi Corporation of Japan, owns 13.1% of the outstanding Common shares of the Company.

10. Share Capital

	1986 (Millions)	1985
Authorized		
5,000,000 Class A Preferred shares of $25 par value each		
28,000,000 Common shares of $1 par value each		
Issued		
1,790,500 $2.5625 Cumulative Redeemable Class A Preferred shares, Series 1	**$ 44.8**	$ 45.0
18,247,530 Common shares	**18.2**	18.2
	$ 63.0	$ 63.2

The Preferred shares may be issued from time to time in one or more series having special rights and restrictions fixed prior to issue of each series by the Directors of the Company.

The Series 1 Preferred shares are retractable at the option of the holder on April 15, 1989 and October 15, 1992 at $25 per share plus accrued and unpaid dividends. The shares are redeemable at the option of the Company commencing April 15, 1989 at $26.25, declining annually to $25 on April 15, 1993.

The Company purchased and cancelled 9,000 Series 1 Preferred shares in 1986 but was required to discontinue the share purchase program due to certain constraints under the rights and restrictions attached to Series 1 Preferred shares.

On December 8, 1986, the Board of Directors of the Company decided not to declare the January 15, 1987 quarterly dividend on the Company's $2.5625 Cumulative Redeemable Class A Preferred shares, Series 1 which would have amounted to $1.1 million.

11. Commitments and Contingencies

In 1985, the Company reached an agreement to cancel its obligation to finance an amount equivalent to its share of exploration and development costs of the Brae oil and gas field in the United Kingdom sector of the North Sea for another participant. Under the terms of the agreement, the Company's United Kingdom subsidiary is contingently liable for up to U.S.$10 million for tax adjustments, relating to the participant, that may arise as a result of the transaction.

As at December 31, 1986, U.S.$10 million from the proceeds of the Company's sale of its oil and gas interests in the United Kingdom was deposited in a special escrow account on behalf of the Company and the purchaser. Release of these funds to the Company is dependent on certain matters related to the above noted contingency being resolved. The amount is included in cash and short-term investments.

The Company has guaranteed the lease commitment of a related company requiring minimum annual rental payments of $7.0 million in 1987, $8.8 million in 1988, $9.1 million in 1989, $9.1 million in 1990, and $11.4 million in 1991. Minimum annual rental payments will escalate to $26.1 million by 2002.

12. Financing Costs

	1986 (Millions)	1985
Interest expense		
Long-term debt	**$ 28.6**	$ 35.7
Other	**1.7**	2.9
	$ 30.3	$ 38.6

13. Other Income

	1986 (Millions)	1985
Dividends from related company	**$ 6.5**	$ 5.8
Insurance recovery	**4.3**	—
Other	**.6**	(.4)
	$ 11.4	$ 5.4

14. Provision for Income Taxes (Recovery)

	1986 (Millions)	1985
Current		
Federal and provincial income taxes	**$ (7.8)**	$ 8.7
British Columbia mining tax	**—**	1.4
	(7.8)	10.1
Deferred		
Federal and provincial income taxes	**3.1**	5.7
British Columbia mining tax	**(2.1)**	1.5
	1.0	7.2
	$ (6.8)	$ 17.3

The difference between the income tax rates recorded and those obtained by applying the combined federal and provincial statutory rates is as follows:

	1986	1985
Statutory federal and provincial income tax rate	**52.0%**	52.0%
Increase (decrease) resulting from:		
Non-deductible payments to provincial governments for mining taxes and mineral land tax	**(8.7%)**	16.1%
Federal resource allowance	**16.4%**	(18.0%)
Earned depletion	**(14.5%)**	(3.7%)
Tax exempt dividend income	**26.2%**	(7.9%)
Loss carry-back effect on investment tax credits previously claimed	**(15.0%)**	—
Other	**(4.2%)**	6.6%
Effective tax rate	**52.2%**	45.1%

15. Extraordinary Items

	1986	1985
	(Millions)	
Loss on disposal of United Kingdom oil and gas interests (Note 5)	**$ (75.5)**	$ —
Adjustments to carrying value of assets net of income taxes of $1.7 million (1985 $13.6 million)	**(3.6)**	(14.6)
Loss on settlement of carried interest obligation net of income taxes of $9.6 million	**—**	(279.4)
Sale of Westshore Terminals Ltd. net of income taxes of $9 million	**—**	72.5
	$ (79.1)	$(221.5)

16. Funds Provided by Continuing Operations

	1986	1985
	(Millions)	
Earnings (loss) from continuing operations	**$ (6.2)**	$ 21.1
Add: Items not affecting working capital		
Depreciation, depletion and amortization	**18.5**	30.9
Deferred income taxes	**1.0**	7.2
Disposals of assets	**(.5)**	—
	$ 12.8	$ 59.2

17. Pension Plans

The Company has pension plans for hourly and salaried employees which at December 31, 1986 had no unfunded past service liabilities.

18. Related Party Transactions

The Company sells metallurgical coal produced from its Balmer mine to Mitsubishi Corporation for resale to nine Japanese corporations under an agreement expiring on March 31, 1990. The Company sells metallurgical coal produced from its Greenhills mine directly to the nine Japanese corporations under annual contracts which expire on March 31, 1987. These contracts have been renewed for the year ended March 31, 1988. At December 31, 1986, Mitsubishi Corporation together with the nine Japanese corporations owned 33.4% of the Company's outstanding Common shares. Sales to these Japanese customers amounted to $173.8 million and $263 million for the years ended December 31, 1986 and 1985 respectively.

Pohang Iron and Steel Company Limited of Korea, which has a 20% interest in the Greenhills Mine Joint Venture, purchases Balmer and Greenhills metallurgical coals from the Company under long-term contracts extending through March 31, 1990 and 2002 respectively. Sales to Pohang amounted to $47.7 million and $65.1 million for the years ended December 31, 1986 and 1985 respectively.

The Company ships substantially all of its coal products through a bulk loading terminal at Roberts Bank, British Columbia which is operated by Westshore Terminals Ltd. Westshore Terminals Ltd. is a wholly-owned subsidiary of British Columbia Resources Investment Corporation. Payments to Westshore Terminals Ltd. for these services amounted to $21.1 million and $24.3 million in 1986 and 1985 respectively.

In 1986 and 1985 the Company reimbursed a subsidiary of British Columbia Resources Investment Corporation $2.3 million and $2 million respectively for the cost of certain centralized management and administrative services.

19. Prior Period Adjustment

As a result of income tax reassessments applicable to the years 1981 to 1983, retained earnings and working capital have been reduced by $9.5 million and $8.6 million respectively and deferred income taxes have been increased by $.9 million at January 1, 1985. The comparative financial statements have been restated to reflect the impact of the tax assessments.

Five-Year Review

	1986	1985	1984	1983	1982
			Restated (5) *(Millions except per share data)*		
Coal Shipments (tonnes)					
Metallurgical (1)	**5.4**	6.9	7.0	5.7	5.0
Thermal (1)	**1.0**	1.2	1.1	.5	.5
Sales ($)	**370.7**	515.1	530.5	433.5	430.6
Earnings ($)					
Continuing operations	**(6.2)**	21.1	28.3	56.1	46.4
Discontinued operations (3)	**(15.5)**	13.6	12.6	3.5	—
Extraordinary items	**(79.1)**	(221.5)	(14.7)	—	21.5
Net earnings (loss)	**(100.8)**	(186.8)	26.2	59.6	67.9
Share Statistics ($)					
Earnings (loss) per Common Share					
Continuing operations (2)	**(.59)**	.90	1.30	3.01	2.55
Discontinued operations (3)	**(.85)**	.75	.69	.19	—
Extraordinary items	**(4.34)**	(12.14)	(.81)	—	1.17
Net earnings (loss) (2)	**(5.78)**	(10.49)	1.18	3.20	3.72
Dividends					
Common shares	**—**	5.21	—	—	—
Preferred shares	**1.92**	2.56	2.56	.62	—
Cash Flow Information ($)					
Funds provided by operations					
Continuing operations	**12.8**	59.2	90.0	123.8	111.3
Discontinued operations (3)	**4.4**	68.9	56.0	13.0	—
Capital expenditures					
Continuing operations	**15.5**	13.4	12.5	125.9	292.7
Discontinued operations (3)	**35.2**	55.7	29.9	54.8	73.1
Financial Position ($)					
Working capital	**24.8**	12.2	2.6	18.6	2.0
Total assets of continuing operations	**578.8**	577.1	658.5	735.3	647.0
Net assets of discontinued operations (3)	**—**	251.6	430.9	313.5	282.9
Total assets	**578.8**	828.7	1,089.4	1,048.8	929.9
Total long-term debt obligations (4)	**477.7**	627.8	554.2	552.9	557.1
Shareholders' equity	**(131.1)**	(21.6)	267.3	238.3	136.3

NOTES

(1) Includes 100% of the Greenhills Mine Joint Venture shipments.

(2) After deducting dividends on Preferred shares.

(3) These amounts relate to the operations and net assets of the Company's United Kingdom oil and gas division that were disposed of on August 22, 1986.

(4) Excludes non-recourse debt of the United Kingdom oil and gas division.

(5) Comparative financial information for 1982 to 1985 has been restated to reflect a prior period adjustment resulting from income tax reassessments applicable to the years 1981 to 1983.

Corporate Directory

Directors

L. Jack Smith*†
President and
Chief Executive Officer
British Columbia Resources Investment Corporation
Vancouver (a diversified natural resource company)

Robert F. Chase*
Vice President, Finance
British Columbia Resources Investment Corporation
Vancouver

Takashi Imai
Managing Director
Nippon Steel Corporation
Tokyo (a steel manufacturing company)

Lucille M. Johnstone†
President and
Chief Operating Officer
RivTow Straits Limited
Vancouver (a marine, shipyard, aggregates and industrial equipment company)

Michael G. McKibbin*
Vice President,
Corporate Affairs
British Columbia Resources Investment Corporation
Vancouver

Hiroshi Ono
Senior Managing Director
Nippon Kokan Kabushiki Kaisha
Tokyo (a steel manufacturing company)

Edwin C. Phillips†
Chairman of the Board
British Columbia Resources Investment Corporation
Vancouver

Ichiro Sonoda
Executive Vice President
Mitsubishi Corporation
Tokyo (a trading company)

†Member of Audit Committee
*Member of Executive Committee

Officers

L. Jack Smith
Chairman of the Board,
Chairman of the Executive Committee and President

Robert F. Chase
Vice President, Finance

Robert H. Brady
Vice President, Marketing

John A. Powell
Vice President,
Coal Mining Operations

Suzanne K. Wiltshire
General Counsel and Secretary

Denis F. Horgan
Assistant Secretary

Subsidiary Management

Robert H. Brady
President
Westar Mining International Ltd.

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Vancouver, Calgary, Regina, Winnipeg, Toronto and Montreal

Preferred Shares Listed
Vancouver Stock Exchange
The Toronto Stock Exchange

Annual Meeting
The annual meeting of shareholders will be held on May 12, 1987.